

Financial conglomerates: supplementary supervision of financial entities

2010/0232(COD) - 16/08/2010 - Legislative proposal

PURPOSE: to ensure supplementary supervision of large financial conglomerates.

PROPOSED ACT: Directive of the European Parliament and of the Council.

BACKGROUND: about 20 years ago, financial groups with business models that combine the provision of services and products in different sectors of financial markets began to develop. These became known as financial conglomerates. Conglomerates may include banks, insurance undertakings, investment firms and possibly asset management companies.

[Directive 2002/87/EC](#) ('FICOD') introduced group-wide supplementary supervision. The objective of this supplementary supervision was to control potential risks arising from double gearing (i.e. multiple use of capital) and group risks, that is, the risks of contagion, management complexity, concentration, and conflicts of interest, which could arise when several licenses for different financial services are combined.

Whilst the banking and insurance directives aim at calculating sufficient capital buffers for the protection of customers and policyholders, FICOD, regulates the supplementary supervision of group risks. This implies that financial entities which have a mutual relationship that affects the risk profiles of both of them must be included in the supervisory scope.

In this way, FICOD supplements the sectoral directives, the Banking [Directive 2006/48/EC](#) ('CRD') and various insurance directives, all of which can be applied on a solo level, per licensed entity, and on a consolidated level, where all licensed legal entities subject to the same directive are aggregated.

A review of FICOD was envisaged some years after its implementation. The review of the FICOD effectively started in 2008 and formed the basis of this legislative proposal. Certain technical issues were included in the Commission's proposal for an Omnibus Directive in October 2009, accompanying the Regulations establishing the new European Supervisory Authorities. During the financial crisis, so-called group risks have materialized all across the financial sector, emphasising the importance of supplementary supervision of inter-linkages within financial groups and among financial institutions. Initiatives similar to the current review were undertaken in the U.S. and Australia, based on the Joint Forum's principles.

The Commission intends to proceed in two steps:

1. with the present proposal, the most urgent technical issues identified during the review, as analysed by the Joint Committee on Financial Conglomerates('JCFC'), are addressed, including the technical issues detected in earlier review exercises. Calls for advice and a consultation were issued to assess the impact of these potential changes;
2. later in 2010, a more fundamental debate will take place in the context of G20 developments regarding supplementary supervision. This debate is likely to focus on supervisory scope and capital related issues.

IMPACT ASSESSMENT: 17 policy options have been developed, assessed and compared with a view to addressing the issues identified in the analysis. Please see the summary of the Commission Staff Working

Document ([SEC\(2010\)0981](#)) for further details. Expected impacts of the preferred policy measures concern the following: supplementary supervision on holding company level and supervisory coordination; identification of financial conglomerates; participations.

The positively assessed policy changes were expected to render the supplementary supervision framework more robust, leading to more effective risk management incentives and practices. This should be beneficial to the international competitiveness position of EU financial groups. These options should contribute positively to containing the risks to financial stability and the possible costs to society.

LEGAL BASE: Article 53(1) TFEU, which is the appropriate legal basis for the harmonisation of rules relating to financial institutions and financial conglomerates.

CONTENT: the aim of this legislative proposal is to amend the IGD, the FICOD and the CRD in order to eliminate unintended consequences and technical omissions in the sectoral directives and ensure that the objectives of the FICOD are effectively achieved. The main points are as follows:

Top level supervision: in order to align supervisory powers at the top level of a conglomerate, to prevent the loss of powers when a group structure changes as well as the duplication of supervision at the conglomerate level, and to facilitate coordination by the most relevant supervisors, the following amendments were positively assessed: include top level holding companies of a banking or an insurance group that are classified as a MFHC, so that provisions and powers that are applied to the former **Financial Holding Company** (FHC) or Insurance Holding Company (IHC) do not disappear when the classification of a group and its holding company changes as a result of an acquisition in the other sector.

In order to ensure that all necessary supervisory tools can be applied, this proposal introduces the term 'mixed financial holding company' into the relevant provisions on consolidated/group supervision in the sectoral directives.

Identification of a conglomerate: provisions governing the identification of financial conglomerates give rise to three sub-problems: (i) the directive does not require the inclusion of 'asset management companies' in the threshold tests; (ii) the threshold tests can be based on different parameters with respect to assets and capital requirements. The provisions are ambiguous as regards the calculation of the tests; (iii) the threshold conditions, given their fixed amounts, are not risk-based, and the notion of expected group risks is not addressed by the threshold test.

In order to tackle these deficiencies, this proposal introduces the following changes:

- the draft directive proposes the inclusion of **asset management companies** at all times. Furthermore 'total assets under management' is introduced as an alternative indicator and there is included the option of proving **guidelines** on the application of the relevant provisions;
- a waiver for smaller groups is introduced, allowing for guidelines for the application of the waiver to smaller groups;
- the text is re-worded properly to distinguish the applicable conditions for groups **below and above the EUR 6 billion** threshold and adds requirements as to possible guidelines for the application of the waiver to larger groups and thus ensures a level playing field.

Treatment of participations: the consistent treatment of participations in day-to-day supplementary supervision is hampered by the lack of relevant information to properly assess group risks. For example, if information about risks with respect to participations in insurance and reinsurance companies cannot be obtained by bank-led conglomerates, they cannot provide their supervisors with the evidence of a satisfactory level of integration of management and internal control with these entities that is necessary for consolidation. In that case, the group needs to deduct such participations from their capital. While the issue of information on minority participations is not yet fully examined, a first step contained in this

proposal is the introduction of a waiver where participation is the only trigger for identification. As long as national company law provisions may hamper the fulfilment of requirements, specific treatment in view of risk concentration and intra group transaction requirements is allowed and may be specified via guidelines. Guidelines may also support the consistent application of supervisory review processes, including specific treatment of participations, as provided for in FICOD, CRD and Solvency II.

Other issues: the proposal deals with the following matters:

- it updates certain definitions in the directives;
- it amends the definition of relevant competent authority and supervisory coordination: certain provisions in FICOD leave room for different interpretations as regards the identification of the relevant competent authorities. An extensive interpretation results in a high number of authorities that must be consulted by the coordinator at the financial conglomerate level. This may undermine the efficient coordination of the work to be carried out by the "college" of a coordinator and relevant competent authorities;
- deletion of the third calculation method: FICOD lists three methods for calculating capital at the conglomerate level. An analysis showed that the third eligible capital calculation method always results in outcomes that are significantly different from methods 1 (consolidation) and 2 (deduction and aggregation). Therefore, the third method should be deleted. By restricting the eligible calculation methods to the consolidation and the deduction and aggregation method, FICOD is also aligned to the sectoral directives it supplements;
- inclusion of reinsurance undertakings: with the introduction of authorisation and supervision of reinsurance undertakings in Directive 2005/68/EC, reinsurance undertakings were included in the scope of regulated entities that can be part of a financial conglomerate. Consequently, a reference to reinsurance undertakings has to be included in FICOD;
- introduction of provisions regarding guidelines in certain areas: in order to allow for further convergence of supervisory practices, a possibility for the European Banking Authority and the European Insurance and Occupational Pensions Authority to issue guidelines is introduced. These guidelines should reflect the supplementary nature of this Directive. By way of example, when assessing risk concentrations on a group wide basis relating to several risk types potentially materializing throughout the group (interest rate risk, market risk, etc.), this assessment should complement the specific supervision of for example large exposures as provided for in the CRD. Guidelines may also support the consistent application of the different supervisory review processes, including specific treatment of participations, as provided for in FICOD, CRD and Solvency II.

FINANCIAL IMPLICATIONS: the proposal has no implication for the budget of the EU.